FRONTIER ADVISORS

20 years

Monthly Markets

September 2014

September seemed to be characterised by a sudden swing in global sentiment in the absence of any single major development. A number of factors were commonly cited. These include geopolitical (Ebola, Russia-Ukraine, ISIS, Hong Kong), fundamental (a lack of breadth in US equity market gains, slowing growth momentum in Europe, Japan and China), and diverging central bank policy paths (US and UK compared with Europe and Japan). Regardless of the causes, growth orientated assets generally sold off (equities, credit and commodities), while volatility picked up from what had been unusually low levels.

Leading up to the US FOMC meeting, markets once again agonised over wording in the Fed's monetary policy statement. The key phrase "considerable time" was left unchanged, referring to how long interest rates would likely remain at current levels. The Fed also confirmed the current QE program will end in October, although it will continue to reinvest the proceeds from maturing securities. The economic data was somewhat mixed. Inflation slowed to 1.7% y/y in August, largely as a result of lower energy prices, but 248,000 jobs were added in September (beating expectations) with higher revisions for both the August and July numbers. This pushed the unemployment rate down to 5.9%.

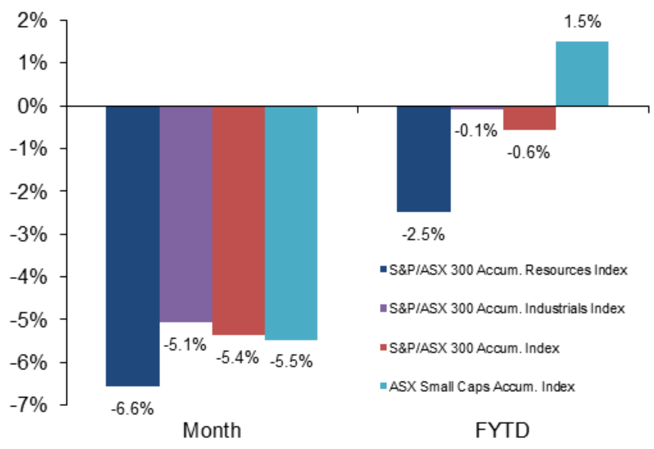
Over in Europe, the ECB left interest rates on hold. However it noted that the downside risks to inflation had increased and that the growth outlook had weakened. This was consistent with earlier weakness in the German ZEW economic sentiment index and IFO business climate index. The final September PMI readings for the region also weakened, to a 14 month low of 50.3. Most concerning was Germany's print of 49.9. This has increased the pressure on the ECB to deliver on its upcoming asset purchasing program, provided it can reach agreement within its own governing council.

A series of weaker data over the past month suggested Japanese growth may have lost some momentum, putting at risk the planned second hike to the consumption tax expected in October next year. August inflation fell back to a 10-month low of 1.1% y/y, imports unexpectedly weakened, while most worryingly there was broad weakness in August's industrial production figures, which showed output contracted by 1.6% y/y. As a result there have been heightened fears the economy may have dipped back into recession in Q3. The more forward looking quarterly business confidence survey, the Tankan survey, also disappointed, showing corporate confidence had faded for two successive quarters.

Things weren't much better in China. Industrial production growth slowed to 6.9% y/y in August to record its weakest growth since the GFC. However, the PMI readings remained in expansionary territory (albeit by a narrow margin) despite slightly missing expectations. The data reinforces the difficulties authorities face in balancing structural reforms with providing targeted support to the economy.

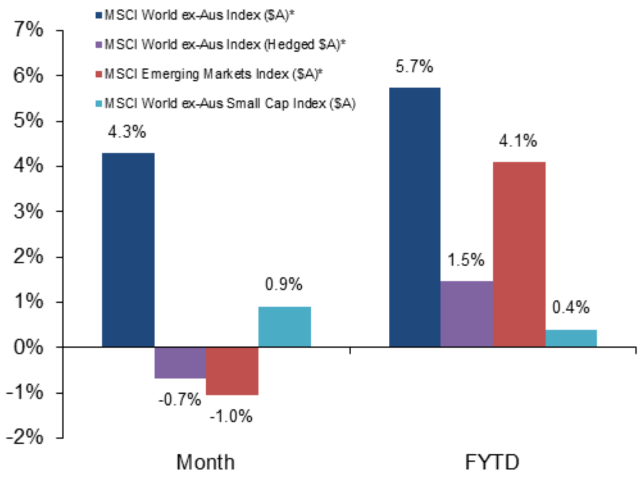
In Australia, the RBA left interest rates on hold as widely expected. The accompanying statement once again made reference to the pace of property price increases, particularly in Sydney and Melbourne. Seen as an attempt to "jawbone" markets, there has been increased talk of introducing macro-prudential controls to rein in investor housing activity. The other key development was the significant decline in the Australian dollar, which fell sharply against the US dollar in particular. While this was no doubt welcomed by the RBA, they noted it remains at historically elevated levels, especially given the continued fall in commodity prices recently.

Australian equities



Australian equities experienced a significant drawdown in September. Negative global growth sentiment and the depreciation in the Australian dollar saw our market underperform all other major developed market indices, with the exception of Hong Kong. At the sector level, it was the cyclically exposed sectors, Materials (-7.6%), Energy (-5.9%) and Financials (-6.6%), that were hardest hit. Resources were impacted by further weakness in commodity prices (iron ore and oil), while financials seemed to bear the brunt of international investors' exodus from our market.

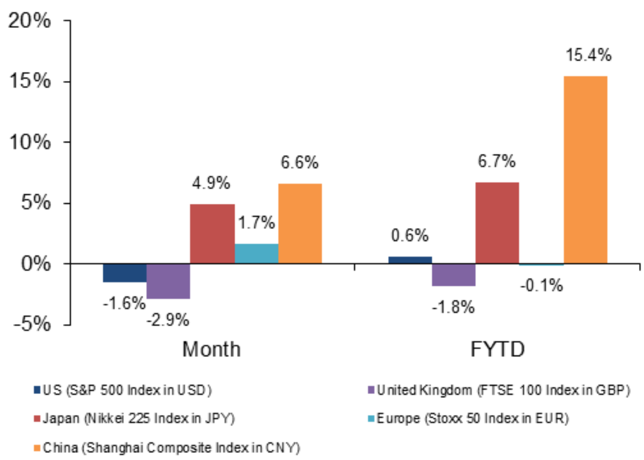
International equities ($A)



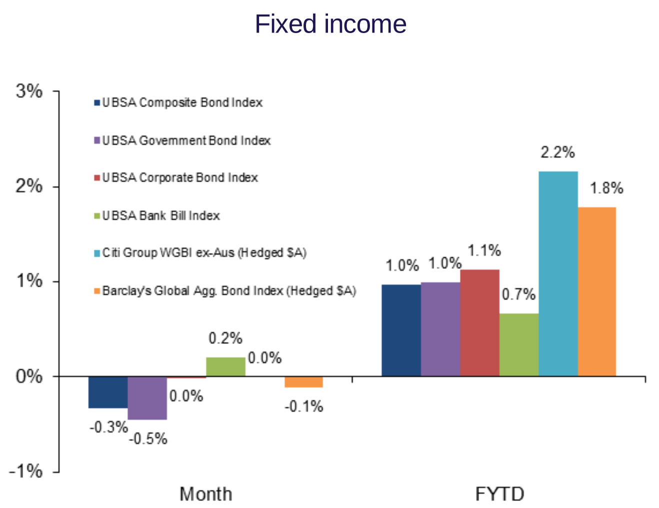
The flexibility of the exchange rate came to the rescue for Australian investors in global markets in September. Despite the broad sell off in international equities, Australian investors reaped a tidy return in developed markets due to the impact of a depreciating Australian dollar.

However, the same could not be said for emerging market equities as they sold off more significantly than the depreciating Australian dollar could counteract. At the country level, Brazil (-19.2%) was once again the biggest detractor owing to uncertainties regarding the outcome of the general election.

International equities (local currencies)

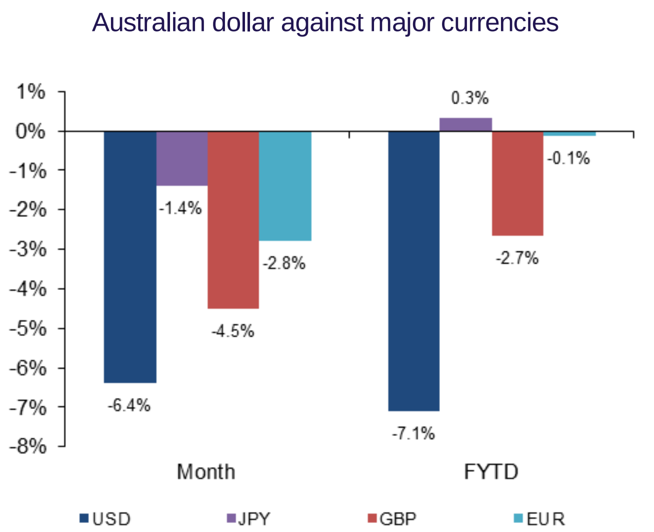


The divergence in growth momentum and the expected path in central bank policy were evident in local equity markets over the past month. The UK and US, which have more positive growth momentum and whose central banks are expected to begin the long process of policy normalisation the earliest, underperformed Europe, which is in the opposite situation. In China, a series of disappointing or subdued economic data series in recent months has generated speculation about the possibility of targeted easing measures. The Nikkei was driven higher by further weakness in the yen.



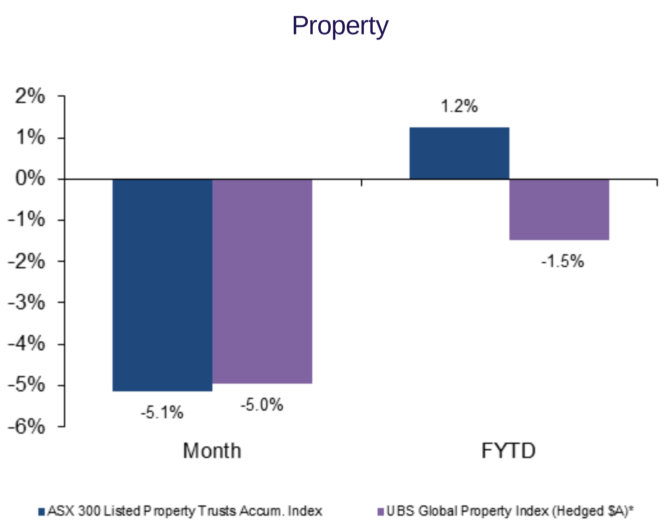
It was a broadly flat month for international fixed income for Australian investors. The US yield curve steepened as the intermediate and long end of the curve sold off by more than the short end. Core European yield curves also steepened. However this was due to a combination of slightly lower short term yields, but slightly higher long term yields.

Australian fixed interest underperformed their international equivalents over the month. Bonds sold off across the curve, but more so at the longer end of the curve.



The Australian dollar experienced a significant depreciation over the past month, particularly against the US dollar, which seemed to be at the epicentre of the initial move. The general risk-off sentiment in global markets saw the declines spread to other major currency pairs by month end.

Looking ahead, the likelihood that the Fed and the Bank of England will begin the process of policy normalisation is expected to place further downward pressure on our dollar over the medium term.



Australian and international listed property trusts recorded significant declines over September. There wasn't much difference between them though as holding a hedged currency exposure was distinctly unfavourable over a month which saw a sharp decline in the Australian dollar.

30-Sep-14	Index value	Month	3 months	FYTD	1 year
Australian equities					
S&P/ASX 300 Accum. Index	45,098	-5.4%	-0.6%	-0.6%	5.7%
S&P/ASX 300 Accum. Industrials Index	88,261	-5.1%	-0.1%	-0.1%	7.9%
S&P/ASX 300 Accum. Resources Index	20,899	-6.6%	-2.5%	-2.5%	-2.3%
ASX Small Caps Accum. Index	5,408	-5.5%	1.5%	1.5%	-0.1%
International equities					
MSCI World ex-Aus Index ($A)*	5,768	4.3%	5.7%	5.7%	20.4%
MSCI World ex-Aus Index (Hedged $A)*	1,146	-0.7%	1.5%	1.5%	18.3%
MSCI Emerging Markets Index ($A)*	480	-1.0%	4.1%	4.1%	11.5%
MSCI World ex-Aus Small Cap Index ($A)	358	0.9%	0.4%	0.4%	12.7%
US (S&P 500 Index in USD)	1,972	-1.6%	0.6%	0.6%	17.3%
United Kingdom (FTSE 100 Index in GBP)	6,623	-2.9%	-1.8%	-1.8%	2.5%
Japan (Nikkei 225 Index in JPY)	16,174	4.9%	6.7%	6.7%	11.9%
Europe (Stoxx 50 Index in EUR)	3,226	1.7%	-0.1%	-0.1%	11.5%
China (Shanghai Composite Index in CNY)	2,364	6.6%	15.4%	15.4%	8.7%
AUD versus …					
USD	0.88	-6.4%	-7.1%	-7.1%	-6.0%
JPY	95.73	-1.4%	0.3%	0.3%	5.0%
GBP	0.54	-4.5%	-2.7%	-2.7%	-6.5%
EUR	0.69	-2.8%	-0.1%	-0.1%	0.0%
Property					
ASX 300 Listed Property Trusts Accum. Index	30,626	-5.1%	1.2%	1.2%	12.3%
UBS Global Property Index (Hedged $A)*	1,845	-5.0%	-1.5%	-1.5%	13.6%
Australian Fixed Interest					
UBSA Composite Bond Index	8,027	-0.3%	1.0%	1.0%	6.0%
UBSA Government Bond Index	8,343	-0.5%	1.0%	1.0%	5.4%
UBSA Corporate Bond Index	8,215	0.0%	1.1%	1.1%	6.1%
UBSA Bank Bill Index	8,118	0.2%	0.7%	0.7%	2.6%
Global Fixed Interest					
Citi Group WGBI ex-Aus (Hedged $A)	-	0.0%	2.2%	2.2%	8.2%
Barclay's Global Agg. Bond Index (Hedged $A)	-	-0.1%	1.8%	1.8%	8.1%
Oil and commodities					
Crude Oil ($/bbl)	91	-5.0%	-13.5%	-13.5%	-10.9%
Copper Spot ($/tonne)	6,720	-4.1%	-4.6%	-4.6%	-7.8%
Gold Spot ($/ounce)	1,212	-5.9%	-8.4%	-8.4%	-9.1%

Fixed income (yields) as at …	30-Sep-14	31-Aug-14	30-Jun-14	30-Jun-14	30-Sep-13
Australia Bank Bill	2.69	2.63	2.68	2.68	2.56
Australia 10 Year Government Bond	3.48	3.29	3.54	3.54	3.81
US 10 Year Government Bond	2.49	2.34	2.53	2.53	2.61
UK 10 Year Government Bond	2.43	2.37	2.67	2.67	2.72
Germany 10 Year Government Bond	0.95	0.89	1.25	1.25	1.78
Japan 10 Year Government Bond	0.53	0.50	0.57	0.57	0.69

* Net dividends reinvested